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USWEST

G. Michael Crumling
Executive Director-
Federal Regulatory

EX PARTE

September 23, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222, SC 1170
Washington, DC 20554

RE: CC Docket No. 96-112: OVS Cost Allocation

Dear Ms. Salas:

Today, Bill Johnston, Jim Hannon, Merlin Jenson and the undersigned, representing U S WEST Communications, Inc. (USWC), met with Jose Luis Rodriguez, Kim Yee, Alicia Dunnigan, Colleen Nibbe, Debbie Weber, Mark Stephens and Ed Dashkin, of the Accounting Systems Branch, to discuss the above-referenced proceeding. A copy of the material distributed at the meeting is attached.

In accordance with Section 1.1206(a)(2) of the Commission's rules, an original and one copy of this letter and the attachments are being filed with your office for inclusion in the record of this proceeding.

Acknowledgment and date of receipt of this submission are requested. A duplicate letter is attached for this purpose.

Please call if you have any questions.

Sincerely,

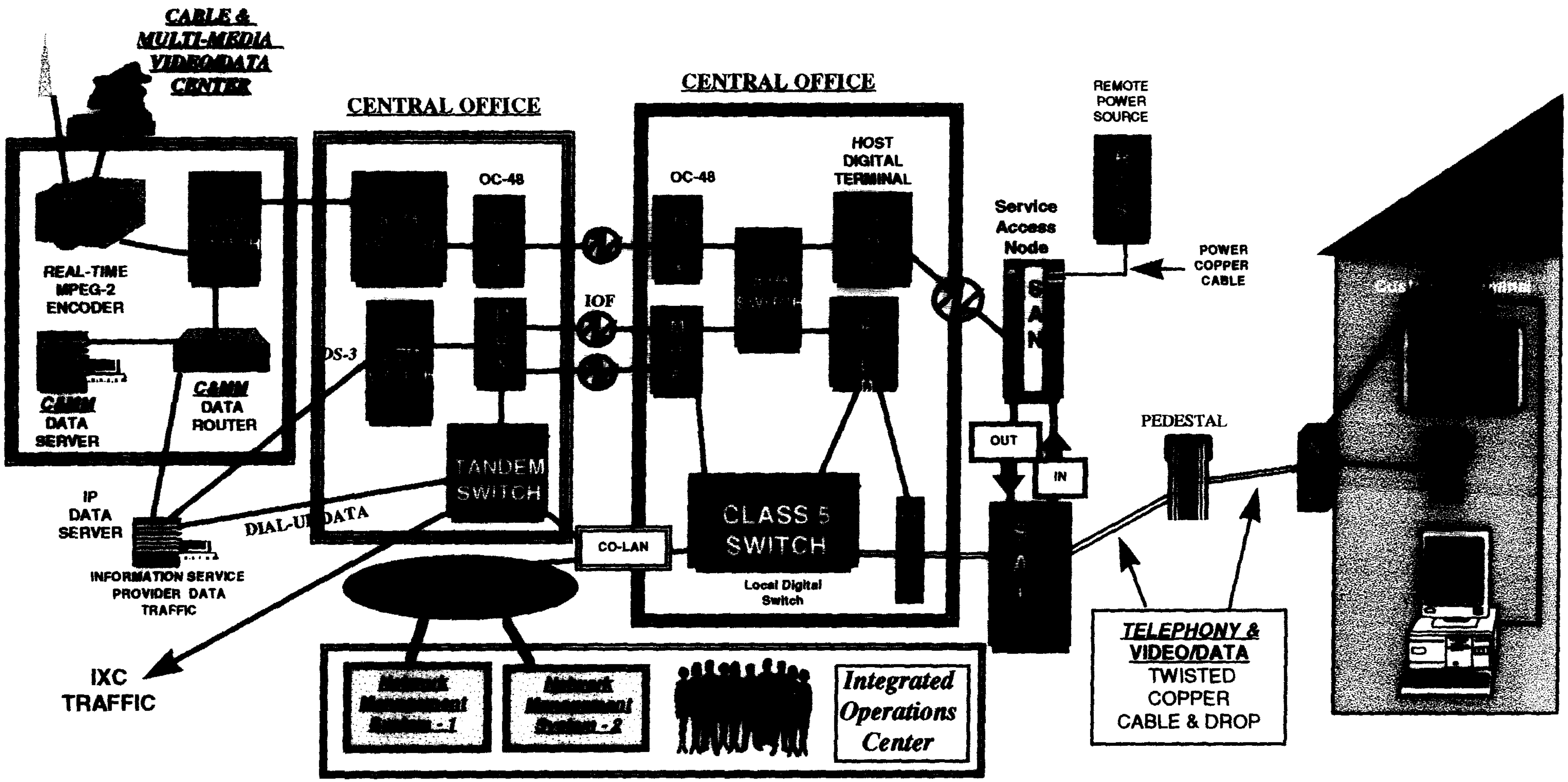
M Crumling

Attachments

cc: Jose Luis Rodriguez
Ed Dashkin
Alicia Dunnigan
Colleen Nibbe
Mark Stephens
Debbie Weber
Kim Yee

No. of Copies rec'd 0+1
List A B C D E

VDSL (Very High Speed Digital Subscriber Line) Over Existing Copper Infrastructure



US WEST Cable Deployment

U S WEST is planning to mass deploy its cable service in Phoenix using VDSL technology.

The economics of providing this service are greatly affected by existing FCC rules.

Deployment will be limited until the viability of VDSL technology is proven in Phoenix.

U S WEST Faces Challenges in Its Cable Deployment

We have higher programming costs.

Competing with entrenched cable incumbents with 100% of Phoenix market. (DBS = 10%, Wireline Cable = 90%.)

Although the cost to deploy a new broadband, cable network is high and capital intensive, it appears economically viable as long as it is not burdened by uneconomic, regulatory driven cost allocations.

U S WEST Must Be Able to Price Competitively

Cost allocations need not and should not prevent ILECs from competing in related businesses where infrastructure can be shared.

Certain Commission cost allocation rules are a disincentive to competition for cable services.

In the past cable companies have advocated cost allocation rules that would ensure they have no competition.

Over-allocation of costs to the cable service will result in financial burdens to the cable business and risk its viability.

Costs Should be Allocated Based on Stand-Alone Telephony Costs

Existing facilities were built for a stand-alone voice grade telephony service.

Therefore, only the incremental cost of enhancing U S WEST's existing telephone network should be assigned to its cable service.

U S WEST is making significant direct investments in head-end cable equipment, ATM switches, set top boxes, transmission and interface devices that are directly assigned to the cable service.

Over-allocation of embedded telephone plant will seriously impact the economic viability of cable service.

Competitive Neutrality is Essential

Currently cable companies have the only broadband path to the home for cable services. In addition, they have no resale or unbundling obligations.

Cable companies are entering the telephone market and are making decisions based on the incremental investment required. Ultimately, the price their customers pay will be determined by the market.

In the Commission's own words, "over-allocation of common costs to nonregulated activities[,] could dissuade companies from entering nonregulated, competitive markets..." (Dkt 96-112 NPRM, para 20)

Competitive Neutrality is Essential (continued)

Requiring telephone companies to allocate a portion of stand-alone embedded telephone cost to their cable services is not competitively neutral and is a disincentive to entering the cable business.

Another option to assure competitive neutrality is to impose Part 64 rules on the cable industry. This is undesirable as it creates more regulation - not less.

Part 64 Rules are Competitively Biased

Current Part 64 rules rely on three year forecasts of peak usage.

- **3 year peak forecasts create bias against introducing new services.**
- **Rules are inconsistent with the concept of UNEs and resale.**

Simultaneous use of facilities was not foreseen.

- **Existing rules were developed for voice grade switched services and did not anticipate use the network simultaneously.**
- **Rules should not be applicable to new entrants in competitive markets.**

Over-allocating cost to cable service requires telephone customers who subscribe to U S WEST's cable service to pay for more than the cost of the loops they are using - effectively paying for a portion of the customers' loops who do not subscribe to U S WEST's cable service.

What's the Problem?

The Commission has not completed its cost allocation docket.

Rules designed in a monopoly environment are inappropriate and anticompetitive when the company is a new entrant competing against entrenched incumbents.

Cost allocation rules developed for a voice grade world do not provide the appropriate framework for new technologies and frustrate the intent of the 96 Telecommunications Act.

Only those incremental costs greater than the stand-alone telephony costs should be allocated to cable; otherwise the over-allocation will seriously jeopardize competitive cable offering such as U S WEST's.

U S WEST's Proposal

U S WEST broadband, cable service will bear its incremental cost of provisioning the service.

Head end, ATMs, IOF, Feeder, HDTs and DSLAMs specific to cable will be directly assigned to cable.

Joint ATMs - allocation will be based on ports.

Joint IOF /Joint Feeder - allocation based on the number of fibers physically being used.

Distribution - allocation based on incremental cost above stand-alone telephony costs.

No price cap index changes would be required because the productivity factor encourages deployment of new services and gives existing customers benefits in advance.

Benefits of U S WEST's Proposal

U S WEST's proposal serves the public interest because customers receive significant benefits at no additional costs:

- **customers get a competitive choice,**
- **customers get access to broadband,**
- **fiber based technology will improve service quality,**
- **cable investment will increase network capacity to the benefit of all services.**

Stand-alone telephony cost assignment is consistent with the price cap rules.

Consistent with economic theory that telephone customers should only be responsible for stand-alone telephony costs.

Benefits of U S WEST's Proposal (continued)

Cable services would be assigned all of the costs for which they are causally responsible.

Regulated telephone services continue to bear only the stand-alone costs of providing telephone service.

Opportunities for cable competition would expand dramatically.

Cable companies will be motivated to accelerate deployment of telephony services.

Recommendation

Utilize open Docket 96-112 to revise Part 64 rules:

- **to approve a stand-alone telephony approach for the introduction of new competitive cable services.**
- **to eliminate 3 year peak forecasts in assigning costs to cable service since such forecasts are biased toward existing regulated services and discourage introduction of new products.**
- **to confirm that the operation of the price cap mechanism is not affected by cable services.**

In the interim, grant U S WEST a waiver of the existing rules so we can proceed with our cable deployment having a clearer understanding of its economic viability.